FILED

NOT FOR PUBLICATION

MAY 18 2017

UNITED STATES COURT OF APPEALS

MOLLY C. DWYER, CLERK
U.S. COURT OF APPEALS

FOR THE NINTH CIRCUIT

STAR INSURANCE COMPANY,	No. 15-56562
Plaintiff-counter-defendant-Appellant,	D.C. No. 8:13-cv-01930-DFM
v.	MEMORANDUM*
SUNWEST METALS, INC.,	
Defendant-counter-claimant-Appellee.	

STAR INSURANCE COMPANY,	No. 15-56568
Plaintiff-counter-defendant-Appellee,	D.C. No. 8:13-cv-01930-DFM
v.	
SUNWEST METALS, INC.,	
Defendant-counter-claimant-Appellant.	

Appeal from the United States District Court
for the Central District of California

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*   This disposition is not appropriate for publication and is not precedent
except as provided by Ninth Circuit Rule 36-3.

Douglas F. McCormick, Magistrate Judge, Presiding

Argued and Submitted April 5, 2017
Pasadena, California

Before: WARDLAW and CALLAHAN, Circuit Judges, and QUIST,[**] District Judge.

Star Insurance Company ("Star") appeals the district court's judgment in favor of Sunwest Metals, Inc. ("Sunwest") on Sunwest's breach of contract claim stemming from Star's rescission of Sunwest's fire insurance policy. Sunwest cross-appeals (i) the court's determination that Star was not required to prove *intentional* misrepresentation to give rise to a right to rescind, and (ii) the court's reduction of Sunwest's judgment award to prevent double recovery. We have jurisdiction under 28 U.S.C. § 1291, and we affirm.

A.

Sunwest operated a recycling facility that processed various commodities including metals, plastics, paper, and glass. Beginning in August 2011, Sunwest had fire coverage under Star's Scrap Dealers Program ("the Program") pursuant to two consecutive year-long policies. To be eligible for the Program, no more than 15 percent of a prospective insured's revenue may come from paper and plastics

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[**]   The Honorable Gordon J. Quist, United States District Judge for the Western District of Michigan, sitting by designation.

processing. Through its broker, Thomas Dunlap Insurance Agency, LLC

("Dunlap"), Sunwest represented that nearly all of its revenue came from metals

processing. That wasn't true; in reality, paper processing comprised the vast

majority—nearly 66 percent—of Sunwest's revenue.[1]

In April 2013, Sunwest suffered a catastrophic fire. Sunwest filed a claim

under its policy, but instead of honoring the policy, Star rescinded it based on

Dunlap's misrepresentations. Sunwest sued Star for, *inter alia*, breach of contract,

and, after a five-day bench trial, the district court granted judgment in favor of

Sunwest, finding that it was owed nearly $978,000 under the policy. The court

determined that Star had waived its right to rescind by failing to investigate

evidence of misrepresentation.

B.

Star waived its right to rescind the policy if it ignored information that

"distinctly implied" misrepresentation of true facts regarding Sunwest's operations.

Cal. Ins. Code § 336. Whether Star had knowledge of misrepresentations is a

question of fact that, after a bench trial, we review for clear error. *See Magnuson*

v. Video Yesteryear, 85 F.3d 1424, 1427 (9th Cir. 1996). Whether the right to

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[1] Sunwest communicated with Star through Dunlap. Sunwest maintains, and Star does not dispute, that Sunwest had no knowledge of Dunlap's misrepresentations.

rescind requires a showing of intentional misrepresentation and whether the district

court properly offset Sunwest's award are questions of law that we review de novo.

See id.[2]

1.

As a general rule, an insurer may "rely upon [the insured] . . . for such

information as it desires" in determining whether to provide coverage. *Old Line*

Life Ins. Co. v. Superior Court, 229 Cal. App. 3d 1600, 1604 (1991) (internal

quotation marks omitted). But it may not blindly ignore evidence of

misrepresentation, collect premiums, and then opportunistically rescind once a

claim is filed. Under California law, "[t]he right to information of material facts

may be waived . . . by neglect to make inquiries as to such facts, where they are

distinctly implied in other facts of which information is communicated." Cal. Ins.

Code § 336. Where an insurer has "before it information that plainly indicate[s]

that the insured's statements [are] not true," it has a "duty of further inquiry" to

determine the "pertinent facts." *Rutherford v. Prudential Ins. Co. of Am.*, 234 Cal.

App. 2d 719, 733–34 (1965). This includes a duty to investigate "information

which if pursued with reasonable diligence" would reveal misrepresentations.

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[2]   Because we uphold the district court's judgment on the question of
waiver, we need not decide whether Star was required to show that Dunlap's
misrepresentations were intentional, rather than negligent.

DuBeck v. Cal. Physicians' Serv., 234 Cal. App. 4th 1254, 1267 (2015) (internal

quotation marks omitted).

The district court identified numerous pieces of evidence spanning nearly

two years that "distinctly implied" the falsity of information in Sunwest's

insurance applications and subsequent communications with Star. For example, (i)

Sunwest's website advertised paper and plastic recycling as a main part of its

business; (ii) a September 2011 site inspection of Sunwest revealed that Sunwest

"fill[ed] large dumpster bins" with, *inter alia*, paper products; and (iii) two other

site inspections—one in January 2012 and one in 2008, the report of which Star

received in February 2012—noted substantial paper processing. Star was clearly

aware that the application information was inconsistent with these facts, as

indicated by its repeated inquiries into Sunwest's operations. The answers Star

received from Dunlap were non-responsive, and simply reiterated that 100 percent

of Sunwest's annual revenue came from metal products.

The district court did not clearly err in finding that Star had before it

information that "distinctly implied" material misrepresentations, and that it failed

to satisfy its duty to investigate such evidence. The duty of inquiry requires an

insurer to not only ask questions, but also to investigate answers. *See DuBeck*, 234

Cal. App. 4th at 1267. Here, Star made inquiries, but then ignored the inadequacy

of the answers it received. Having turned a blind eye for nearly two years, Star

waived its right to rescind when Sunwest filed a claim. *See id.* at 1256, 1268.

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2.

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Sunwest cross-appeals the district court's reduction in its recovery from Star

by a portion of Sunwest's recovery from Dunlap. Sunwest settled its suit against

Dunlap for, *inter alia*, making erroneous representations to Star. The district court

found that approximately $232,000 of the $535,000 settlement represented losses

Sunwest incurred under its fire insurance policy. Because Sunwest's nearly

$978,000 recovery from Star on its breach of contract claim also covered its fire

loss, the district court offset the judgment against Star by the $232,000 it received

from Dunlap to prevent double recovery. Thus, Sunwest's total recovery from Star

amounted to approximately $746,000, not including prejudgment interest and costs

of suit under Federal Rule of Civil Procedure 54(d)(1).

The district court acted within its equitable discretion in granting the offset.

See Plut v. Fireman's Fund Ins. Co., 85 Cal. App. 4th 98, 108 (2000). California

courts have declined to extend the collateral source rule to contract-based claims.

Id. at 107–08. Unlike tort damages, "[c]ontract damages are generally limited to

those within the contemplation of the parties when the contract was entered into."

Id. at 108 (internal quotation marks omitted) (citing Restatement (Second) of

Contracts § 347 cmt. e, which states that "[t]he injured party is limited to damages based on his actual loss caused by the breach"). Because Sunwest recovered contract damages from Star, its "recovery is reduced if [its] losses are avoided or mitigated." *Id.* Sunwest's losses were mitigated by its settlement with Dunlap. Therefore, the district court did not err in limiting Sunwest's total recovery to its "actual loss." *See id.* (internal quotation marks omitted).

AFFIRMED.